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IN THE

Supreme Court of the United States

October Term, 1971

Case Number 71 - 208

GEORGE E. DUDLEY, Receiver For Insurance Investors Trust Company,

Plaintiff-Respondent,

-vs-

SOUTHEASTERN FACTOR AND FINANCE CORPORATION, JAMES M. McDANIEL, ERNESTINE H. McDANIEL, et al.,

Defendants-Petitioners.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JAMES M. McDANIEL and ERNESTINE H. McDANIEL, Defendants-Petitioners, Petition this Court for Writ Of Certiorari to review the judgment and opinion of the United States Court of Appeals For The Fifth Circuit entered in the case of GEORGE E. DUDLEY, Receiver For Insurance Investors Trust Company V. SOUTHEASTERN FACTOR AND FINANCE CORPORATION, JAMES M. McDANIEL, ERNESTINE H. McDANIEL, et al., on July 9, 1971.

OPINION BELOW

The opinion and judgment of the United States Court of Appeals For The Fifth Circuit is as yet unreported but is appended hereto, (Appendix) the opinion and judgment being dated July 9, 1971.

JURISDICTION

The opinion and judgment of the United States Court of Appeals For The Fifth Circuit was entered and dated July 9, 1971. The jurisdiction of this Court is invoked as provided under the provisions of 28 U.S.C.A. Section 1254.

QUESTION PRESENTED

The question presented is whether the United States Court of Appeals For The Fifth Circuit properly reversed and remanded the opinion and judgment of the United States District Court For The Northern District of Georgia, Atlanta Division, wherein Motion To Dismiss in behalf of JAMES M. McDANIEL and ERNESTINE H. McDANIEL was sustained and granted, the District Court holding that the Complaint filed in behalf of GEORGE E. DUDLEY, Receiver for Insurance Investors Trust Company, Plaintiff-Respondent, did not set forth therein a federal claim under the Securities Act of 1933 or the Securities Exchange Act of 1934 or an independent ground of federal Court jurisdiction with regard to the common law.

STATUTES INVOLVED

(1) Section 17, Securities Act of 1933, 15 U.S.C. Section 77q (1964)

(2) Section 3, Securities Exchange Act of 1934, 15 U.S.C. Section 78c (1964)

(3) Section 10, Securities Exchange Act of 1934, 15 U.S.C. Section 78j (1964)

(4) SEC Rule 10b-5, 17 C.F.R. Section 240.10b-5 (1968)

(5) 28 U.S.C. Section 1653 (1964)

(6) Federal Rules of Civil Procedure (9b)

The two Texts which frame the answer by the United States Court of Appeals For The Fifth Circuit to the query whether the Complaint allegations were enough to invoke federal jurisdiction under the securities legislation provide:

Section 10(b) of the Securities Exchange Act of 1934:

> "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> * * * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. Section 78j(b) (1964)

Rule 10b-5 of the Securities and Exchange Commission:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security." 17 C.F.R. Section 240.10b-5 (1971)

Federal Rules of Civil Procedure 9(b)

"Fraud, Mistake, Condition of the Mind. In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

STATEMENT OF CASE

Civil Action Complaint was brought by GEORGE E. DUDLEY, Receiver for Insurance Investors Trust Company (hereinafter referred to as IITC), Plaintiff-Respondent, to recover damages allegedly sustained by IITC as a result of Defendant's-Petitioner's allegedly wrongfully withholding from IITC (a shareholder of Defendant Southeastern Factor and Finance Corporation) its proportionate share of a liquidating distribution from Southeastern. Jurisdiction is alleged under the Securities Act of 1933 (15 U.S.C. Section 77a, et seq.), 28 U.S.C. Section 1337, and 28 U.S.C. Section 1332. The complaint alleges that in July, 1966 IITC and Southeastern entered into a written contract pursuant to which IITC

conveyed to Southeastern approximately 621,000 shares of the common stock of another corporation (Acme, Inc.) in exchange for approximately 168,000 shares of the preferred stock of Southeastern. IITC subsequently transferred some of its Southeastern stock to First American Life Insurance Company of Alabama, which company thereafter was also a preferred shareholder of Southeastern. During the summer of 1967, Defendant Atlantic Services, Inc., and Defendant Southeastern entered into an agreement pursuant to which Southeastern was to sell to Atlantic certain shares, and options to purchase additional shares of preferred stock in First American Life Insurance Company of Alabama, and Atlantic was to issue to Southeastern 34,000 shares of Atlantic's convertible preferred stock. This latter transaction allegedly was pursuant to a plan of liquidation adopted by Southeastern whereby all creditors and shareholders were to receive assets of Southeastern. Defendant Atlantic allegedly distributed the shares which it had agreed to transfer to Southeastern directly to the creditors and common shareholders of Southeastern, pursuant to Southeastern's instructions, but in so doing ignored the preferred position of IITC and First American (of which latter corporation Atlantic was itself a preferred shareholder). IITC claims that the transaction between Atlantic and Southeastern was intended to, and did, result in a fraud upon certain shareholders of Southeastern in that they were not given their liquidating shares as required by Southeastern's liquidation plan, the allegation of fraud not being made with particularity. (Appendix A)

Defendants Ernestine and James M. McDaniel and Defendants Maurice E. Olen, C. A. Scheuerman, and Crown Services Corporation moved to dismiss on grounds

of (1) failure to state a claim, (2) improper venue, (3) failure to state a claim under the Securities Acts and improperly joining with the claim arising under the Securities Acts a claim based on common law grounds of misfeasance, malfeasance, fraud, and unjust enrichment, and (4) failure to show on the face of the complaint that the action was brought within the period of the statute of limitations. In addition, the Olen defendants moved to dismiss for insufficiency of process and lack of personal jurisdiction. (Appendix A)

The District Court held that the Complaint did not state a claim under the Securities Act of 1933 or the Securities Exchange Act of 1934, the federal claims being dismissed, and that since it did not appear from the Complaint that an independent ground of federal court jurisdiction existed with regard to the common law claim, the state claim was dismissed without prejudice to its being refiled if an independent ground of federal court jurisdiction could be demonstrated. (Appendix A)

GEORGE E. DUDLEY, Receiver for Insurance Investors Trust Company, Plaintiff-Respondent appealed the aforesaid District Court decision to the United States Court of Appeals For The Fifth Circuit, that court reversing and remanding, which is the subject of this Petition For Writ Of Certiorari. (Appendix B)

SUMMARY OF REASONS FOR ALLOWANCE OF WRIT

Through broad and liberal interpretation by the Courts the intended federal coverage by the Securities Acts and Rules thereunder has been stretched completely out of line with the intention of Congress when

said statutes were enacted. (See footnotes 2 and 6 of Decision.)

ARGUMENT AND CITATIONS OF AUTHORITY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

It is respectfully submitted and strongly urged that the Complaint does not set forth a claim arising under the Securities Acts. Those statutes give rise to causes of action arising out of fraudulent or deceptive acts connected with the sale or purchase of securities. The United States Court of Appeals For The Fifth Circuit recognized in *Hooper v. Mountain States Securities Corp.*, 282 Fed. 2nd 195 (1960) that a significant purpose of Section 10(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78j(b)) and the regulations authorized therein (SEC Regulation X-10B-5) was to extend to sellers of securities the same protection against fraudulent and other unlawful schemes which the Securities Act of 1933 afforded to those defrauded in the purchase of securities. Any injury Plaintiff-Respondent received as a result of the acts set forth in the Complaint did not result from the sale or purchase of securities, but, rather, resulted from the purchaser Corporation's failure properly to distribute among its shareholders certain securities which the Corporation itself had purchased. Stripped of adornment, the Complaint alleges a complaint against Defendants-Petitioners for failure in a duty to see to it that IITC received its proportionate share of a distribution in connection with a partial liquidation by Southeastern. Neither of the Securities Acts referred to covers the situation, and no jurisdiction existed based upon a federal claim. In the Complaint, all that is said is that "the distribution of

shares of Atlantic to common stockholders of Southeastern was in fraud of this creditor," creditor meaning IITC. It is respectfully submitted that under the Securities Act of 1933, the fraud contemplated is something more than a mere failure to give a stockholder its claimed share of a dividend. In the Complaint no claim is made that the contract between Atlantic and Southeastern was fraudulent, and thus no attack has been made on the only "purchase" or "sale" which is involved in the allegations in the case. There must be a "sale" or "offer of sale" which is being attacked in order for jurisdiction to attach under the federal statutes. *Holmberg v. Williamson*, 135 F. Supp. 493 (D.C. N.Y., 1955). The leading case of *Birnbaum v. Newport Steel Corporation*, 193 F.2nd 461 (C.A. 2), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952), interpreted the phrase "in connection with the purchase or sale of any security" in both statute and rule as limiting permissible Plaintiffs in a civil action under the rule to "purchasers" or "sellers" of securities. See *Rekant v. Desser*, 425 F.2d 872, 877 (C.A. 5, 1970), *Iroquois Industries, Inc. v. Syracuse China Corporation*, 417 F.2d 963 (C.A. 2, 1969), cert. denied 399 U.S. 909, 90 S.Ct. 2199, 26 L.Ed. 2nd 561 (1970); *Greenstein v. Paul*, 400 F.2d 580, 581 (C.A. 2, 1968). In *Herpich v. Wallace*, 430 F.2d 792, 808 (C.A. 5, 1970) it was said:

> ". . . a plaintiff must frame his complaint so that it appears with reasonable clarity therefrom either that a purchase or sale of securities by the plaintiff is the subject of the fraudulent scheme or that the inducement of such a purchase or sale is a purpose of the scheme. That the conduct complained of may be reprehensible does not require the conclusion that a federal remedy must be furnished. . . . If Congress had intended that the federal courts

> inquire into every decision affecting the management of corporations and then fashion a new federal law on the fiduciary responsibilities of corporate directors, officers, and controlling persons, presumably so revolutionary a federal intervention into an area traditionally handled by the states would have been clearly expressed. . . ."

In trend through interpretation it has been held that the purchaser-seller requirement does not demand a sale in the strict common law traditional sense and as a result it was held in *Ruckle v. Roto American Corporation*, 339 F.2d 24 (C.A. 2, 1964) a company caused by its control group to issue treasury shares at prices arbitrarily established was a seller within the rule, (See *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219 (C.A. 2, 1968) (en banc), cert. denied sub nom. *Marley v. Schoenbaum*, 395 U.S. 406, 89 S.Ct. 1747, 23 L.Ed. 219 (1969)); it was held in *A. T. Brod & Co. v. Perlow*, 375 F.2d 393 (C.A. 2, 1967) that a stockbroker whose customer ordered stock, but refused to pay for it if its market price had not increased by the payment date, was and had standing as a purchaser, it was held in *Dasho v. Susquehanna Corporation*, 380 F.2d 262 (C.A. 7), cert. denied sub nom. *Bard v. Dasho*, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed. 2d 470 (1967) that when Susquehanna Corporation agreed to merge the American Gypsum Company into it by issuing shares to Gypsum's stockholders pursuant to a prescribed exchange ratio, Susquehanna's exchange of its shares for Gypsum's assets in order to merge the two companies was a sale of securities, and Susquehanna had standing to assert a violation of the rule, the "forced sale" rationale being applied to a tender-offer situation in *Crane Company v. Westinghouse Air Brake Company*, 419 F.2d 787 (C.A. 2, 1969), a merger situation, in *Vine v. Beneficial Finance*

Company, 374 F.2d 627 (C.A. 2) cert. denied, 389 U.S. 970 88 S.Ct., 463, 19 L.Ed. 2d 460 (1967) and in a liquidation case, *Coffee v. Permaian Corporation*, 434 F.2d 383 (1970). The aforesaid rationale and broad interpretation by the Courts has now stretched the intended coverage by the Securities Acts and rules completely out of line with the intention of Congress, and Defendants-Petitioners respectfully request Writ of Certiorari to review the current status of Security Act cases and clarify the coverages afforded thereunder. It is further pointed out that under Rule 9(b) of the Federal Rules of Civil Procedure that a claim of fraud and the circumstances in connection therewith shall be stated with particularity. (See footnotes 2 and 6 of Decision.)

CONCLUSION

Defendants-Petitioners JAMES M. McDANIEL and ERNESTINE H. McDANIEL respectfully request Writ Of Certiorari to the United States Court of Appeals For The Fifth Circuit and for reversal of the judgment and opinion of July 9, 1971, wherein it was held that the Plaintiff-Respondent (IITC) had standing as a seller to sue under Section 10(b) of the Securities Exchange Act and Rule 10b-5, reversing and remanding the judgment and opinion of the District Court sustaining a Motion To Dismiss for failing to set forth a claim in the Plaintiff-Respondent Complaint under the Securities Acts or an independent ground of Federal Court jurisdiction.

Respectfully submitted,

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CERTIFICATE

This is to certify that the Appendix A contained herein is a true and correct copy of the entire Appendix on file in this Court.

This _____ day of , 1971.

Clerk, United States Court of
Appeals for the Fifth Circuit

By: _____